



Greater Southwest Acquisition Center

8 April 2015

(b) (6)

Senior Manager – Government Contracts
Eaton Corporation
8609 Six Forks Road
Raleigh, North Carolina 27615

RE: Eaton Corporation's Multiple Award Schedule Contract GS-07F-9460G

Dear (b) (6):

The third option period for Eaton Corporation's Multiple Award Schedule (MAS) contract, GS-07F-9460G, was exercised on 24 July 2012 extending the period of performance of the contract through 28 February 2017 (modification 0057). Modification 0058 (effective 24 July 2012) incorporated the Government's right to modify the terms and conditions of the contract pending resolution of any current Audit findings and stated that the contract may be cancelled if negotiations are not successful in resolving the audit findings IAW the Cancellation's clause 552.238-73.

The findings within Audit Report Number A120087/Q/9/X13067, dated 30 September 2013, comprised the basis from which the requests for information were made. The 2013 audit revealed that Eaton Corporation failed to (b) (4) (Finding 1); that the (b) (4) (Finding 2); and that the schedule invoices did not reference the GSA contract number.

An extensive review and analysis of the most recent data provided by Eaton Corporation on 31 October 2014, Subject: Price Reduction Clause (PRC) and GSA Contract No. GS-07F-9460G, Request for Information Related to Discounting Practices, 20 October 2014, Subject: Revised Commercial Sales Practices (CSP) Charts / Tables, 17 October 2014, Subject: Allocation of Discount for Value Added Functions Performed by Distributors and 15 October 2014, Subject: Master Distributors within Eaton's CSP, has been performed; however, the Contracting Officer has determined that the underlying audit findings and concerns associated with the contract have not been resolved as evident by the following comments and / or concerns. Unresolved concerns

819 Taylor Street
Fort Worth, Texas 76102

include, but are not limited to, the disclosure of all discounts and the price / discount relationship statement.

Commercial Sales Practice Format (CSP)

In an effort to resolve the findings addressed within the audit, numerous requests for a current, accurate and complete commercial sales practices (CSP) chart have been made, however, the data provided has been unsuccessful in satisfying the Contracting Officer requests. All agreements (b) (4)

(b) (4) that result in a lower sale price are considered discounts (please refer to clause 552.212-70 Preparation of Offer (Multiple Award Schedule) (Aug 1997)) and not a concession or deviation. These discounts must be broken out and disclosed within the CSP (please refer to CSP-1 Commercial Sales Practices Format, section (3)).

In addition, the maximum discount provided under each SIN and product should be reflected on the commercial sales practices (CSP) chart. For the Contracting Officer to perform a thorough analysis, the maximum discount provided needs to be broken out - (b) (4)

(b) (4). On 31 October 2014 (Request for Information Related to Discounting Practices), Eaton Corporation identified the maximum discount provided under SIN(s) 383 5, 412 14, 412 15, 412 19, 412 21 and 412 50 as (b) (4) %. (b) (4) was provided for SIN(s) 412 51, 412 52 and 412 99 due to how the SIN(s) are invoiced; and it was also noted that SIN 412 17 was not addressed within the letter. The aforementioned letter further states that the "maximum discount is inclusive of all concessions including those related to (b) (4)

The concessions noted as included within the maximum discount are, for the most part, not concessions but are instead either a part of the overall discount provided to the customer, a deviation, or neither. (b) (4)

(b) (4) and rebates provided which result in a lower sales price is a discount. The same rationale applies to (b) (4)

(b) (4). One time goodwill discounts to charitable organizations or universities are an acceptable deviation per the CSP-1, but Eaton Corporation has only identified sales to charitable organizations. General

sales to charitable organizations are not a deviation, but are part of the sales practices that are to be notated.

Warranty or warranty related issues may be a concession (please refer to clause 552.212-70 Preparation of Offer (Multiple Award Schedule) (Aug 1997)). Eaton Corporation did not provide enough information to allow the Contracting Officer to make a definitive determination as it relates to warranty concessions.

Satisfaction of customer complaints would potentially be an acceptable deviation per CSP-1 Commercial Sales Practices. However, Eaton Corporation did not provide a narrative that clearly described the situations that led to deviations from its standard commercial practice, how often they occurred, and the controls employed to assure the integrity of the pricing. The deviation circumstances or situations were not provided, nor were the controls that have been put in place to monitor said deviations. Eaton Corporation only indicated that (b) (4) within the letter dated 31 October 2014 (Subject: Price Reduction Clause). Furthermore, no explanation regarding a change in process was provided, as Vice Presidents were required to approve additional discounts to (b) (4) reference Eaton Corporation correspondence dated 10 January 2014.

The commercial sales practices (CSP) chart also requires that the disclosure of non-standard discounts include the frequency in which they occur. Eaton Corporation stated on 31 October 2014 (Subject: Request for Information Related to Discounting Practices) that the data was inconclusive on how often non-standard discounts were provided (above the stated discount), as the data obtained revealed an occurrence frequency of (b) (4). Eaton Corporation explained that there was a “massive amount of transaction data, large variety of part numbers, disparate order entry systems, differing data formats and large number of data fields feeding into the calculations (b) (4)”. Eaton Corporation further stated that the “results confirm Eaton’s suspicions that GSA’s broad request for the frequency of non-standard discounts is (b) (4)”. (b) (4)

In the second letter received on 31 October 2014, Eaton Corporation indicated that the standard discounts are exceeded (b) (4) of the time for (b) (4) to meet competition. No additional frequencies were noted, therefore, it is not clear if this (b) (4) was included in the occurrence frequency percentage reported above.

It is acknowledged that there may be a large amount of data to sort through. However, by virtue of submitting an offer under the MAS program, the Contractor is acknowledging there is an acceptable system in place to track and monitor all discounts and deviations provided to commercial customers. Further, due to Eaton Corporations vast number of distributors and negotiated pricing within the (b) (4)

(b) (4) it is not inconceivable that discounts greater than the stated discount occur (b) (4) of the time. This frequency is on par with the (b) (4) occurrence rate noted during the audit. Therefore, based on the aforementioned, the Contracting Officer could not confirm the CSP-1 information to be current, accurate and complete.

Price / Discount Relationship

Eaton Corporation submitted two (2) attachments within the Price Reduction Clause (PRC) letter dated 31 October 2014. Eaton Corporation's attention is first directed to Attachment 1, in which Eaton Corporation explained the classification of customers, the distributor allowance / rebate program, basis of award customer and deviations. Please refer to the first paragraph of the section titled "Customer Classification". The first paragraph indicated that the discount to the government customers will be the same whether the sale is direct from Eaton Corporation or the (b) (4). It was not clear how this is enforced as the agreements obtained from the auditors indicate that the (b) (4) is "authorized to sell products at such prices and terms that (b) (4) determines".

Paragraph one of the Attachment 1 also indicates that ..."discounts will only be extended to (b) (4) for schedule contract sales, and as such, these sales would not trigger the Price Reduction Clause." Any additional discounts afforded to (b) (4) that exceed the information reflected in the CSP could result in a violation of the price reductions clause. The agreed upon relationship between Eaton Corporation and their (b) (4) has to be monitored with all the other pricing discount relationships established.

The (b) (4) section of Attachment 1 is confusing as the (b) (4) is not reflected and the negotiated pricing structure is under the (b) (4). The only (b) (4) that would be shown in the (b) (4) section pertains to the (b) (4) as that is the only (b) (4) provided. If the program is truly only open to (b) (4) then there would not be any (b) (4) reflected in this area and brief explanation as to why would be provided.

It should also be noted that the first paragraph of the (b) (4) section states that GSA's pricing is based upon (b) (4) and that the (b) (4) (b) (4)

The "Basis of Award Customer" section of Attachment 1, under part B. Price Discount Relationship, second paragraph states that "Eaton Corporation establishes GSA pricing based on sell to (b) (4); our (b) (4) ...", this statement should not be shown within the discount relationship

statement. The discount relationship statement only confirms the discounts that must be maintained between the basis of award (BOA) customer and GSA.

The section titled “Deviations – Nonstandard Discounts” of Attachment 1 contains a sentence that comprises the second paragraph, in which it states that “(b) (4) receive discounts under competitive requirements, with (b) (4) exceeding the published discount”. This statement does not meet the definition of a deviation. The government considers a competitive situation as a standard commercial practice and not a deviation. This fact has been stressed multiple times to Eaton Corporation both verbally and in writing.

Eaton Corporation is now directed to the second attachment received within the Price Reductions Clause (PRC) letter dated 31 October 2014, titled “Attachment 2”. Attachment 2 explains what sub-categories the customer classification are comprised of and the price discount relationship is re-stated. The section titled “Major Categories” should be reviewed to ensure that only those customers that purchase products directly from Eaton Corporation are reflected. It appears (from the descriptions provided) that (b) (4) and the (b) (4), (b) (4) may be like the previously removed (b) (4), and do not purchase the product directly from Eaton Corporation. Only the customer classes that Eaton Corporation sells to directly should be reflected on the CSP.

Under the “Sub-Classification” section of Attachment 2, the (b) (4) definition reflects the (b) (4) is engaged in the design, sale, servicing and manufacturing of uninterruptible power supply (UPS) systems. However, the agreements obtained from the auditors are not reflective of any design or manufacturing; only the sale of certain products, Eaton Corporation authorized warranty service, prompt customer service, engineering assistance and Eaton Corporation authorized modified products.

The Price / Discount Relationship is reflected on both Attachment 1 and Attachment 2 from the Price Reductions Clause (PRC) letter dated 31 October 2014. The relationship reflects a (b) (4) differential will be maintained under all SIN(s). However, the spreadsheet dated 29 May 2014 reflects conflicting information under SIN(s) 412 19 (b) (4) and 412 21 (b) (4). The statement also does not address any allowance provided the (b) (4) that may sell to the Government.

Invoicing

Eaton Corporation continues to experience issues revolving around the information that is required to be reflected on invoices when providing services to the Government. On 31 October 2014 (Subject: Request for Information Related to Discounting Practices), Eaton Corporation stated that the maximum discount provided under SIN(s) 412 51, 412 52 and 412 99 could not be “(b) (4)”

(b) (4)

”. The letter further states “Labor or services, which make up the bulk of Eaton’s sales under these SINs, are typically represented by a single contract line item number (CLIN) on an RFQ, RFP, or Solicitation. The contract is then issued in the same format with a single CLIN for labor or services. This same lump-sum approach is commonly used in the acquisition of labor or services by Eaton’s commercial customers.” It was also noted Eaton Corporation did not provide an explanation as to how the maximum discount of (b) (4) was determined under SIN 412 50, as 412 50 is a service SIN.

On 25 June 2008 (Modification AO73), the previous contracting officer incorporated an “Invoicing Procedures Plan” (as provided by Eaton Corporation) in response to a concern raised during Eaton Corporations 2007 audit. The concern was that Eaton Corporation (b) (4), instead of per contract requirement of description, quantity, unit of measure, unit price and extended price of the items delivered. The plan stated, in part, that Eaton Corporation’s billing plan had been modified and made to comply with the invoicing requirements located in paragraph g of 52.212-4 Contract Terms and Conditions. Clause 52.212-4 (g) Contract Terms and Conditions – Commercial Items (Feb 2012) (Deviation 2007) Invoice states that the invoice will reflect: in section (1) part (iii) *Contract number, contract line item number and, if applicable, the order number* and in part (iv) *Description, quantity, unit of measure, unit price and extended price of the items delivered*.

The 31 October 2014 letter indicated maximum discounts cannot be provided due to Eaton Corporation’s method of invoicing. The invoicing concern is identical to the concern raised in the 2007 audit in which it was found that Eaton Corporation (b) (4). Therefore, the plan submitted on 31 October 2014 is unacceptable because it was the government’s understanding that those issues were to have been corrected in 2007 via the previously incorporated “Invoicing Procedures Plan”. However, based upon the findings associated with the 2013 audit, it is apparent that Eaton Corporation did not comply with said plan and continues doing business status quo. The aforementioned issue is a serious concern to both the Contracting Officer and the government.

The only 2013 audit invoicing concern raised was that Eaton Corporation wasn’t reflecting the GSA Schedule Contract Number on their invoices. As the contract file revealed the incorporation of the “Invoicing Procedures Plan” in which the system was updated to comply with the requirements of 52.212-4 (g), Eaton Corporation was asked for an explanation (as reflection of the contract number is part of the requirement for information to be shown on the invoice). On 7 November 2013, Eaton Corporation responded that the “requirement to add GSA contract number to invoices was brought to Eaton’s attention by the IOA during the CAV on 19 October 2012”. Eaton

Corporation explained that if the “contract number was not referenced in the applicable block on the contract award or if the contract number is only referenced in the body of the purchase order, Eaton is forced to use the actual contract number or purchase order number when entering orders for processing. If Eaton fails to do this, the invoice will not match the order exactly and payment is delayed. However, effective 22 October 2012, an internal change was initiated to allow the manual addition of the contract number to orders before invoicing and now prints in the body of the invoice”. No explanation was provided by Eaton Corporation explaining the lapse in not incorporating the Invoicing Procedures Plan as stated after the 2007 audit and the 26 January 2010 CAV report (in which Eaton Corporation was notified for the second time that the contract number needed to be referenced on the invoices).

Valued Added Functions / (b) (4)

Eaton Corporation has not been able to provide consistent or concise information on the value added functions that an (b) (4) would perform under the contract to support an allowance greater than the discount provided to the Government. The letter dated 17 October 2014 reflects that Distributors provide value added functions by providing: (b) (4)

(b) (4)

A secondary set of value added functions was received on 31 October 2014 and was inconsistent with the information received on 17 October 2014. Eaton Corporation stated that (b) (4) perform services involving substantive resources such as (b) (4)

(b) (4); and have historically made purchases in significantly greater volume than the future purchase volume anticipated from the Government.” The letter further states that “(b) (4) services to (b) (4)

(b) (4) to Eaton for all purchase orders received through the schedule contract to ensure proper accounting and reporting of all sales for the quarterly Industrial Funding Fee report.”

The information provided contains many items that may not be considered or approved as a value added function by the Contracting Officer or government. Value added functions, to be considered an allowance, should not be standard business practices (b) (4) as these are functions that all businesses carry out. Allowances for such would not be provided and any proposed allowance must be supported by a clear value added function, not based

upon commitments (either purchase or source) or sales (either future or historical) unless adequate supporting information has been provided.

A value added function allowance would only be applicable if (b) (4) are participating in sales of products / services under the contract. It is not clear from the contract file if there are indeed (b) (4) on the contract, as the latest CAV (28 November 2014) states that there are no (b) (4) on the contract. The terms and conditions loaded into GSA eLibrary do not reflect a listing but instruct one to call Eaton Corporation for an approved listing. If there are no (b) (4) on the contract, the value added function information is not applicable.

Other Concerns

In addition to the aforementioned comments and / or concerns, issues indirectly raised by the audit and review of the information and contract surfaced, such as:

1) Noted within the audit was a delay experienced by the auditors, as Eaton Corporation did not fully comply with the request for providing the (b) (4). The Contracting Office too encountered the same issue, with the response that the items had been provided to the auditor and if additional information was needed then a specific request should be made. Specific requests were made and a template with the requested information was provided, however Eaton Corporation responded by stating the information was (b) (4). The minimal information obtained as it pertained to the (b) (4) was obtained from the auditor. Those agreements appear to be part of the underlying basis to the contract (i.e. discounts and value added functions), as are the negotiated prices under the (b) (4). Per the contract, clause 552.215-71 Examination of Records by GSA (Multiple Award Schedule)(Jul 2003) allows such review and said documents should have been provided to the Contracting Officer within a reasonable amount of time.

Per information received from Eaton Corporation on 25 June 2014, there are over (b) (4) providing value added functions in varying degrees on behalf of Eaton Corporation. It is acknowledged that this is a vast number of (b) (4); however, Eaton Corporation should have a system in place to monitor the agreements and any services or discounts provided under each.

2) The terms and conditions uploaded into GSA eLibrary indicate that the prices are not inclusive of Federal, State and local taxes and duties levied, which conflicts with clause 52.212-4 (k) Contract Terms and Conditions – Commercial Items (Feb 2012) (Deviation 2007) Taxes.

3) Eaton Corporation has not been pro-active in maintaining the contract's underlying terms and conditions (i.e. Mass Mods). Eaton Corporation's MAS contract is currently under terms and conditions set forth in refresh 22. Refresh(es) 23 was released on 17 April 2014; 24 was released on 1 January 2015; and 25 was released on 17 February 2015.

4) Eaton Corporation needs to decide and maintain if discounts or multipliers are used under their commercial practices. Information received on 25 June 2014 indicate that (b) (4) pricing utilized discounts; (b) (4) utilize multipliers and (b) (4) utilize discounts.

The Contracting Officer has determined that it is in the best interest of the Government to cancel Eaton Corporation's Multiple Award Schedule Contract, GS-07F-9460G, IAW the Cancellations clause, 552.238-73. The cancellation will be effective thirty (30) days after the effective date shown on the fully executed SF-30. Cancellation is due in part, but not limited to the following:

- Competitive situations, negotiated (b) (4) and (b) (4) continuing to be incorrectly noted as deviations. The range of discounts provided under each of these need to be aligned and notated on the Commercial Sales Practices chart as discounts provided to the customer in order for the Government to have a concise picture of Eaton Corporation's commercial practices.
- Discounts provided under service SIN(s) that cannot be tracked or monitored due to Eaton Corporation's invoicing process.
- Inconsistent Value Added Functions for (b) (4) (if (b) (4) are participating on the contract) that do not correlate to the few agreements seen or are everyday functions carried out by a business.
- Discounts under product SIN(s) that exceed the stated discount (b) (4).

If you have any questions or concerns, please contact me at 817.850.8164 or via email at jamila.buchanan@gsa.gov; or Dion Duarte, Schedule 56 Branch Chief, at 817.850.8408 or via email at dion.duarte@gsa.gov.

Sincerely,

Jamila Buchanan
Contracting Officer